

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

Number: **200910029**

Release Date: 3/6/2009

CC:ITA:4:SAIskow  
MASP-120491-08

Third Party Communication: None  
Date of Communication: Not Applicable

UILC: 61.40-00, 165.00-00

date: February 02, 2009

to: Carol Polley  
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subject: FEMA's Alternative Housing Pilot Program

Legend:

Agency = Federal Emergency Management Agency (FEMA)

Program = Alternative Housing Pilot Program

Problem = individuals in the Gulf Coast region who, due to the hurricanes of the 2005 season (Katrina and Rita, in particular) have ongoing housing needs

Solutions = sustainable and permanent affordable housing

Mission = providing temporary housing options

Grantee	=	state
Act 1	=	The Robert T. Stafford Disaster Relief and Emergency Assistance Act
Act 2	=	Section 234 of the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006, Pub. L. No. 109-234, 120 Stat. 460
Act 3	=	The Fair Housing Act (Title VIII of the Civil Rights Act of 1968)
Disaster	=	hurricanes of the 2005 season (Katrina and Rita, in particular)
B	=	traditional travel trailers and mobile homes
C	=	historically underserved groups such as persons with disabilities, the elderly, and renters
H	=	Texas
N	=	Louisiana
J	=	Mississippi
K	=	Alabama

You have requested our views regarding the tax consequences to individuals of assistance provided under Agency's Program. The Program is designed to provide Solutions for Problem. The information provided below is based solely on the facts that Agency has provided to us.

**Facts:**

The Program authorized a one-time waiver of Act 1, which legally binds the Agency to Mission. The purposes of the Program are to find better ways to provide housing to victims hardest hit by the Disaster than B, and to address the needs of C by funding Solutions. See Act 2. To participate in the Program, each Grantee had to agree to limit participation to Problem. Because the need for housing from the Disaster greatly exceeds the number of units the Program will provide, it is anticipated that the Program will provide housing units only for Problem.

The Agency designed and administered the Program as competitive grants to Grantees affected by the Disaster, and ultimately awarded five projects—two in N and one each in H, J, and K. The Program is designed to assist two classes of individuals—(1) those whose principal residences were destroyed and are being compensated for their loss

by being provided with a principal residence (Class 1 Individuals) and (2) those who never owned a principal residence and are being provided with the opportunity to acquire a principal residence (Class 2 Individuals).

Although each Grantee has different eligibility criteria (e.g., establishing income levels or requiring background checks, which are among the more common criteria), each Grantee is required to give first priority to Problem and to ensure full compliance with Act 3.

In H, the administering agency plans to transfer ownership of a principal residence to eligible individuals at no cost. In most cases, the principal residence will be placed on land that is currently owned by the individual who will occupy the principal residence. Most eligible individuals will be those whose principal residences were rendered uninhabitable by the Disaster or whose insurance was insufficient to make needed repairs for damage caused by the Disaster. It is also anticipated that most eligible individuals will be low-income.

In N, J, and K, the administering agencies plan to assist mostly low- and moderate-income individuals in purchasing a principal residence for the first time by selling the principal residence at a discounted price to the prospective occupants. Eligible individuals will not be required to repay the difference between the full price and the discounted price unless they terminate their occupancy early.

## **Class 1 Individuals**

### *Issue*

What are the federal income tax consequences to Class 1 Individuals who are being provided with a principal residence under the Program?

### *Law, Analysis, and Conclusions*

Section 165(a) of the Internal Revenue Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(c)(3) limits any personal casualty loss to that arising from a sudden, unexpected, or unusual event, including hurricanes and other natural disasters.

Section 1.165-7(b) of the Income Tax Regulations provides that the amount of a personal casualty loss is the lesser of (1) the difference in the fair market value of the property before the casualty and its fair market value after, or (2) the adjusted basis of the property immediately before the casualty.

In determining the amount of loss actually sustained, proper adjustment shall be made for any salvage value and for any insurance or other compensation received.

Section 1.165-1(c)(4). With respect to "other compensation received," disaster victims who receive government grants or whose government loans are cancelled must reduce their casualty losses by the amount of the grant or loan cancellation, to the extent that the purpose of the government grants or loan cancellation is to compensate them for losses to their damaged or destroyed property. See Rev. Rul. 76-144, 1976-1 C.B. 17 (grants) and Rev. Rul. 71-160, 1971-1 C.B. 75 (loan cancellation).

By analogy, to the extent that Class 1 Individuals receive a principal residence under the Program to compensate them for losses they sustained as a result of Disaster, the value of the principal residence provided will be treated as "other compensation received" and reduce any personal casualty loss.

The general rule is that if a Class 1 Individual properly claims a casualty loss deduction on an original return and in a later year receives reimbursement for the loss, the individual does not amend the original return but reports the amount of the reimbursement in gross income in the tax year it is received to the extent that the casualty loss deduction reduced the individual taxpayer's income tax in the tax year in which he or she reported the casualty loss deduction. Section 1.165-1(d)(2)(iii).

Section 3082(a) of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654, 2907 (HERA) however, provides an exception to this general rule. Section 3082(a) of HERA provides that, notwithstanding any provision of the Code, if a taxpayer claims a deduction for any tax year with respect to a casualty loss to a principal residence (within the meaning of § 121 of the Code) resulting from Problem, and in a subsequent year receives a hurricane relief grant (including amounts under Act 2) as reimbursement for the loss, the taxpayer may elect to file an amended income tax return for the tax year in which the deduction was allowed (and for any tax year to which the deduction was carried) and reduce (but not below zero) the amount of the deduction by the amount of the reimbursement.

Class 1 Individuals who are being provided with a principal residence under the Program are receiving compensation for their casualty loss. As a result, the value of a principal residence they receive either offsets any casualty loss in the year of casualty (§ 1.165-1(d)(i)) or has to be recognized in a later year as "tax benefit" income if the casualty loss was taken in a year prior to the year the principal residence was received and such casualty loss deduction reduced the Class 1 Individual's income tax in that year (§ 1.165-1(d)(2)(iii)). However, as noted above, section 3082(a) of HERA permits taxpayers to elect to file an amended return to reduce certain previously taken casualty losses when the taxpayers receive certain hurricane relief grants, including competitive grants provided under Act 2. See Notice 2008-95, 2008-44 I.R.B. 1076, for instructions on how and where to file amended returns to take advantage of section 3082(a) of HERA.

If a Class 1 Individual properly claimed a casualty loss in a prior year for damage or destruction of a principal residence, and receives a principal residence in a later taxable year with a value exceeding the amount of the casualty loss deduction, the individual reduces basis in the damaged or destroyed principal residence by the amount of such excess. In addition, the Class 1 Individual includes such excess in income as gain, unless the gain can be excluded from income under § 121 or its recognition can be deferred under § 1033. For example, amounts that an individual receives for the destruction (within the meaning of § 1.121-4(d)) of a principal residence, are treated as received for the sale of the residence. Thus, such a Class 1 Individual may exclude up to \$250,000 of the gain received for the destruction of the residence. (As noted above, however, Class 1 Individuals must include in income under the “tax benefit” rule that portion of the value of the principal residence reflecting a prior year’s casualty loss deduction to the extent such deduction reduced the individual’s income tax in that year (or may elect to file an amended return under section 3082(a) of HERA and reduce the amount of its previous deduction by the amount of the reimbursement). Class 1 Individuals may not exclude such portion from income under § 121 nor defer including it in income under § 1033).

**Class 2 individuals:***Issue*

Must Class 2 individuals include in income the value of a principal residence they receive under the Program?

*Law, Analysis, and Conclusions*

Section 61 and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

The Service has held, however, that payments made under legislatively provided social benefit programs for the promotion of general welfare are not includible in a recipient’s gross income. For example, Rev. Rul. 74-205, 1974-1 C.B. 20, states that payments to needy families whose homes have been taken by government action are excludable from income under the general welfare exclusion where the payments are designed to assist needy families in acquiring a decent, safe, and sanitary home of modest standards. Rev. Rul. 76-144 concludes that grants made under the Disaster Relief Act of 1974 to help individuals or families affected by a disaster meet extraordinary disaster-related necessary expenses or serious needs in the categories of medical, dental, housing, personal property, transportation, or funeral expenses (and not in the categories of nonessential, decorative, or luxury items) are excluded from gross income under the general welfare exclusion. Likewise, Rev. Rul. 98-19, 1998-1 C.B. 840, holds that relocation payments made by a local jurisdiction to an individual moving from

a flood-damaged residence to another residence, are not includible in the individual's gross income.

The principal residences provided to Class 2 individuals under the Agency's Program are in the nature of general welfare and are not includible in their gross income.

We hope that this information has been helpful. If you have any further questions, please contact Sheldon Iskow at (202) 622-4920.